

G-7 Initiative Local Bond Market Development

Broadening The Data Base and Technical Assistance

Ceyla Pazarbasioglu

Division Chief

Capital Markets and Financial Infrastructure

International Monetary Fund

The views expressed herein are those of the author and should not be attributed to the IMF, its Executive Board, or its management.

Topics of Discussion

- Changing Global Financial Landscape
- Implications for EM Local Bond Markets
- Capitalizing on the Positive Dynamics – Enhancing Information Flow in EM Countries
- Technical Assistance: Role of IFIs

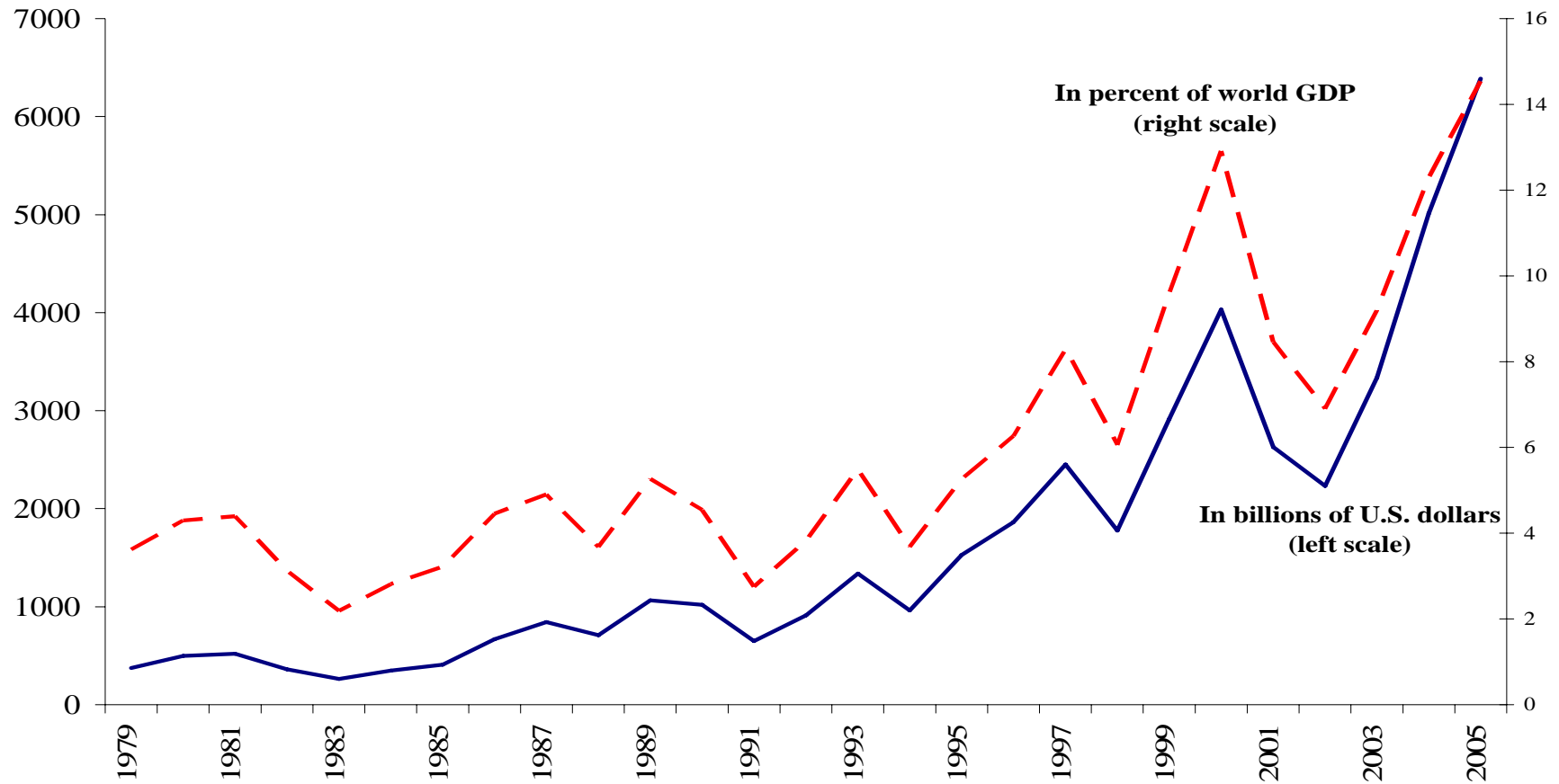
I. Changing Global Financial Landscape

Structural Changes in Global Financial Markets Impacting EM Countries

- Financial globalization
- Increasing asset base and changing asset allocation of institutional investors
- Reduction of home bias and global investor focus on EM countries
- Increased flows to debt-like instruments

Financial Globalization

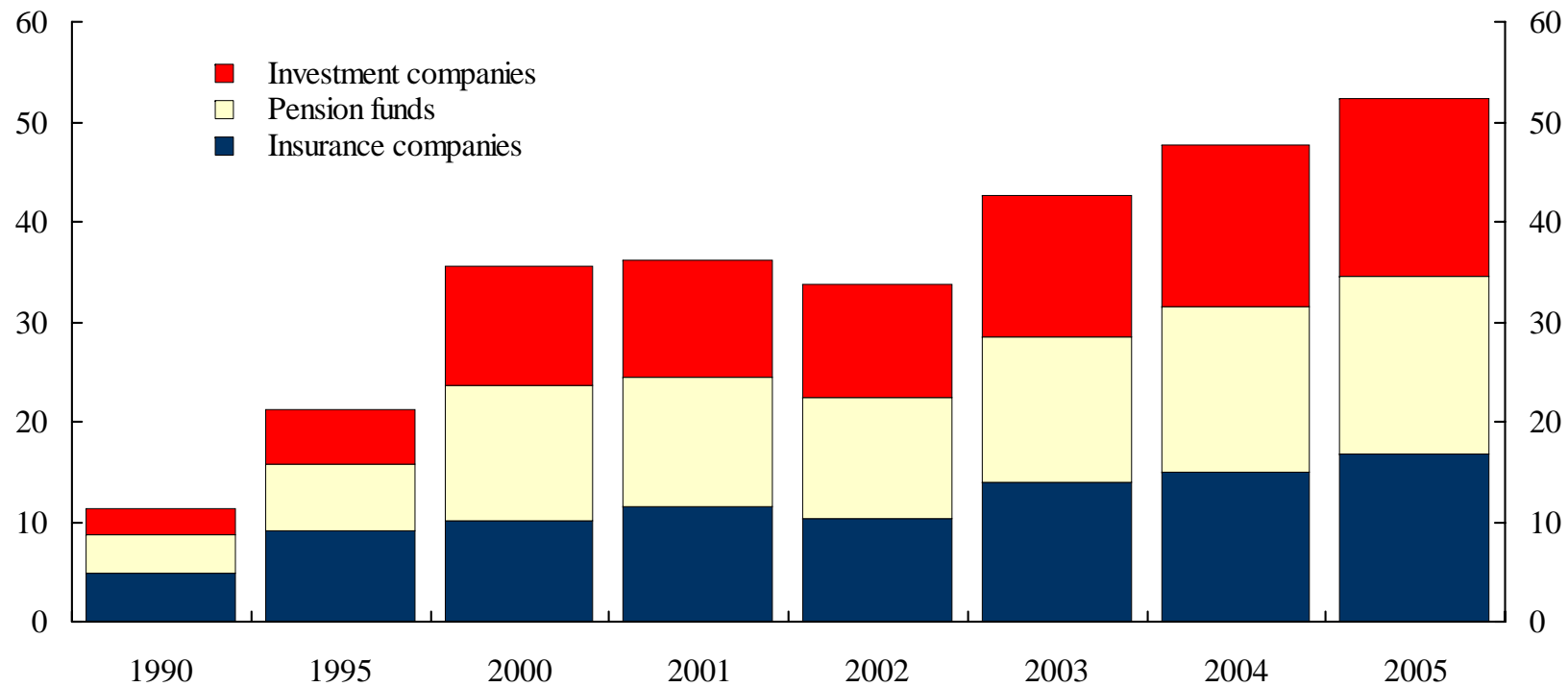
Total Global Capital Inflows



Source: IMF staff calculations based on *IFS* and *WEO*.

Assets Under Management of Institutional Investors in MM Countries Growing Rapidly

(In trillions of U.S. dollars)

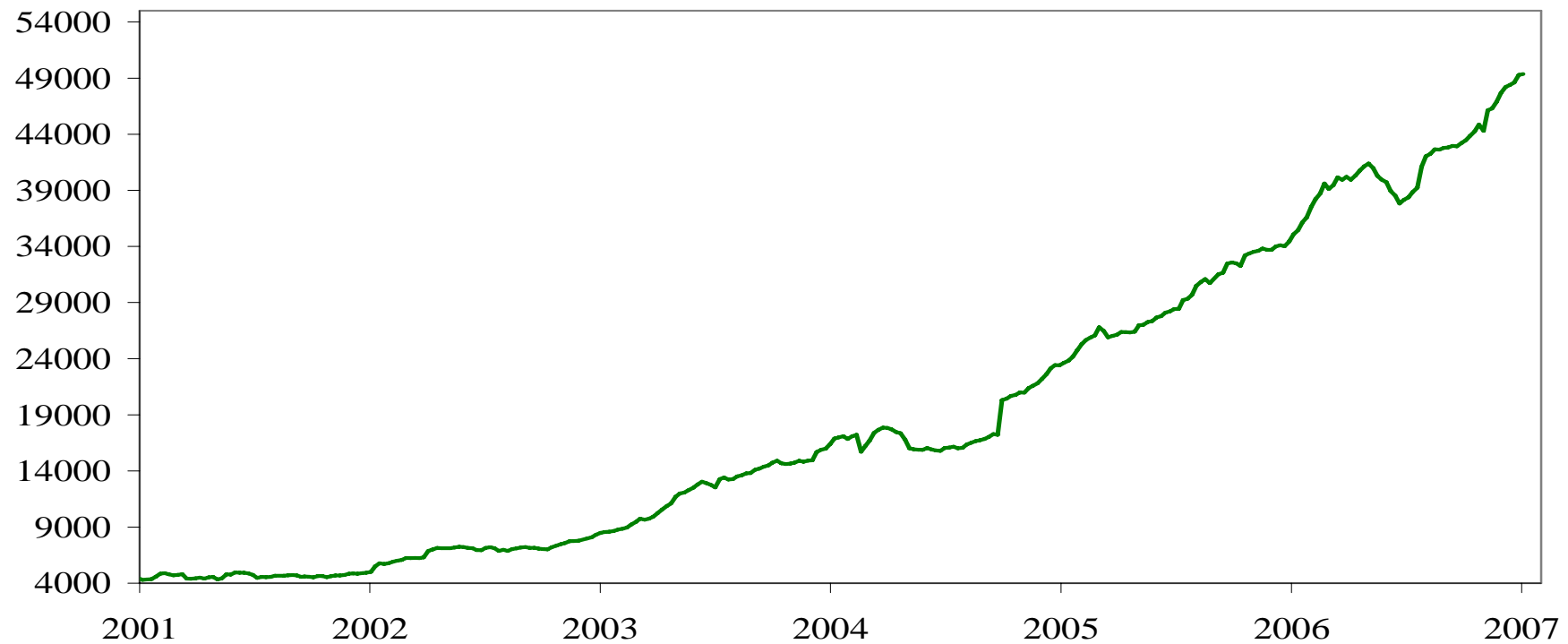


Sources: International Financial Services, London; OECD; and IMF staff estimates.

Foreign Institutional Investor Inflows Are Rising

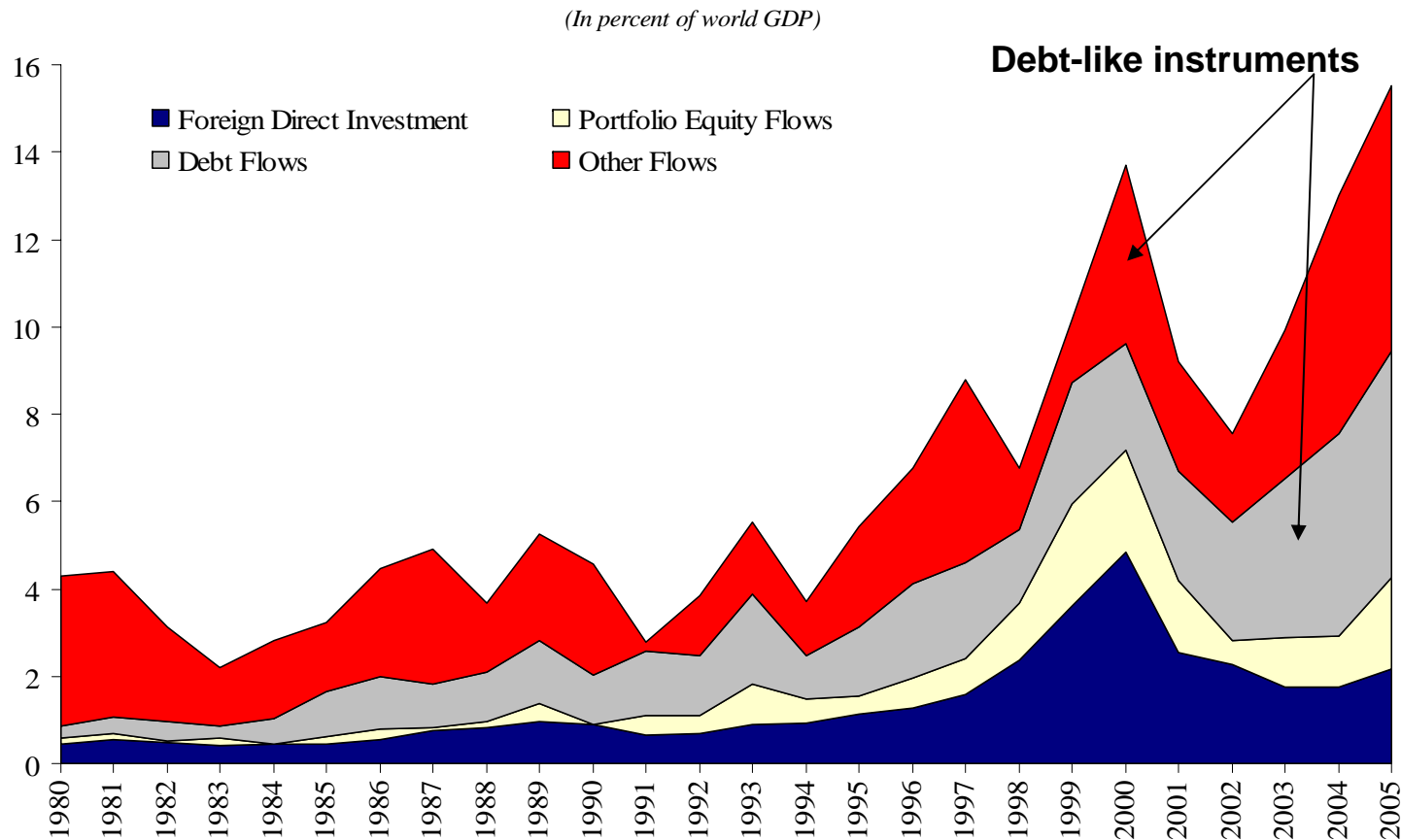
- MM institutional investors seeking higher yielding EM assets.

AUM of Emerging Market Bond Funds
(In billions of U.S. dollars)



Source: Emerging Portfolio Fund Research, Inc.

Capital Flows to Debt-Like Instruments Increasing

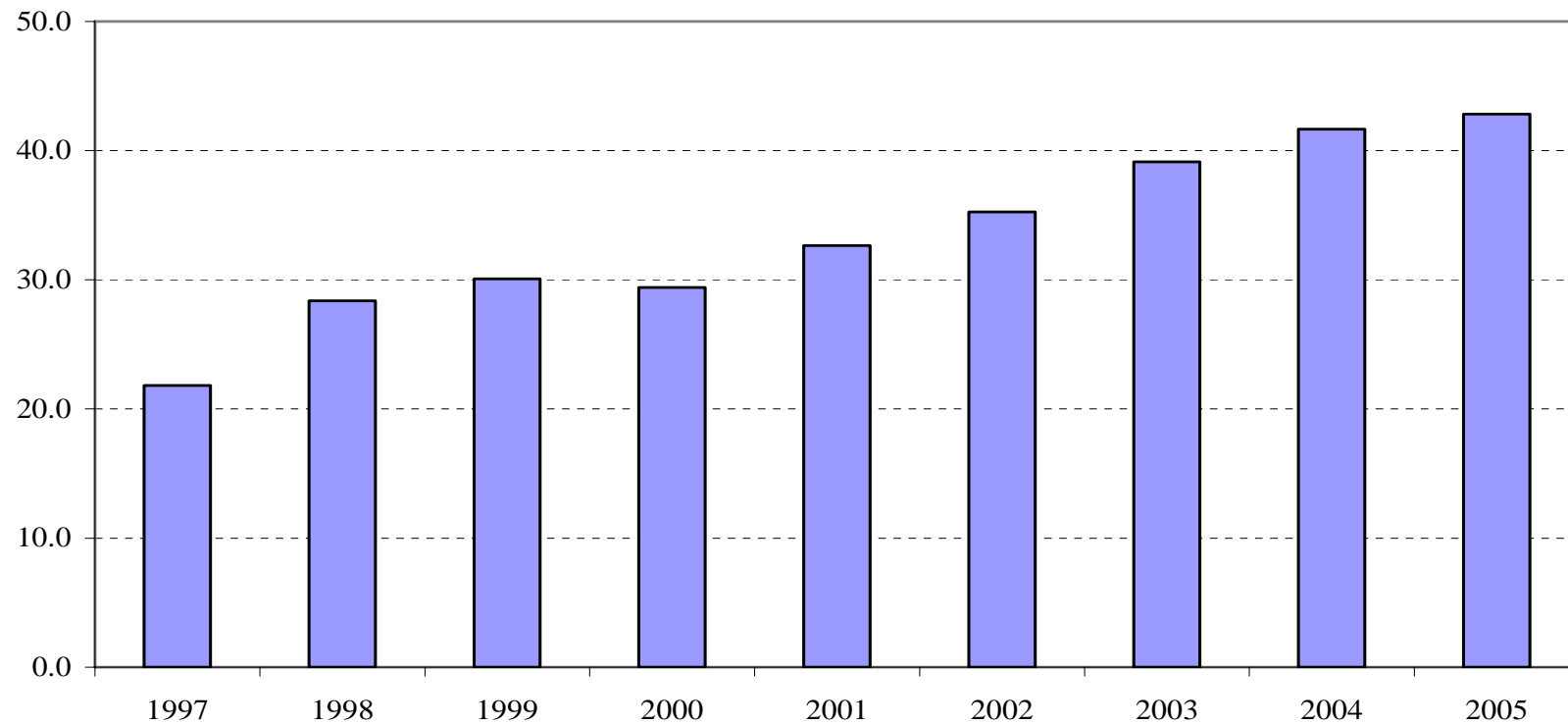


Source: IMF staff calculations based on data from IMF, IFS and WEO.

II. Implications for EM Local Bond Markets

EM Local Bond Markets Are Growing

**Selected Emerging Markets, Outstanding Domestic Debt Securities 1/
(Percent of GDP)**



Source: BIS

EM Local Bond Markets Are Still Evolving As An Asset Class

Supply

- Domestic debt growth in EM outpacing External Debt
- EM sovereign external debt markets seeing a decline in supply
- Local government bond markets have developed rapidly
- “Crowding in” of the private sector bond markets

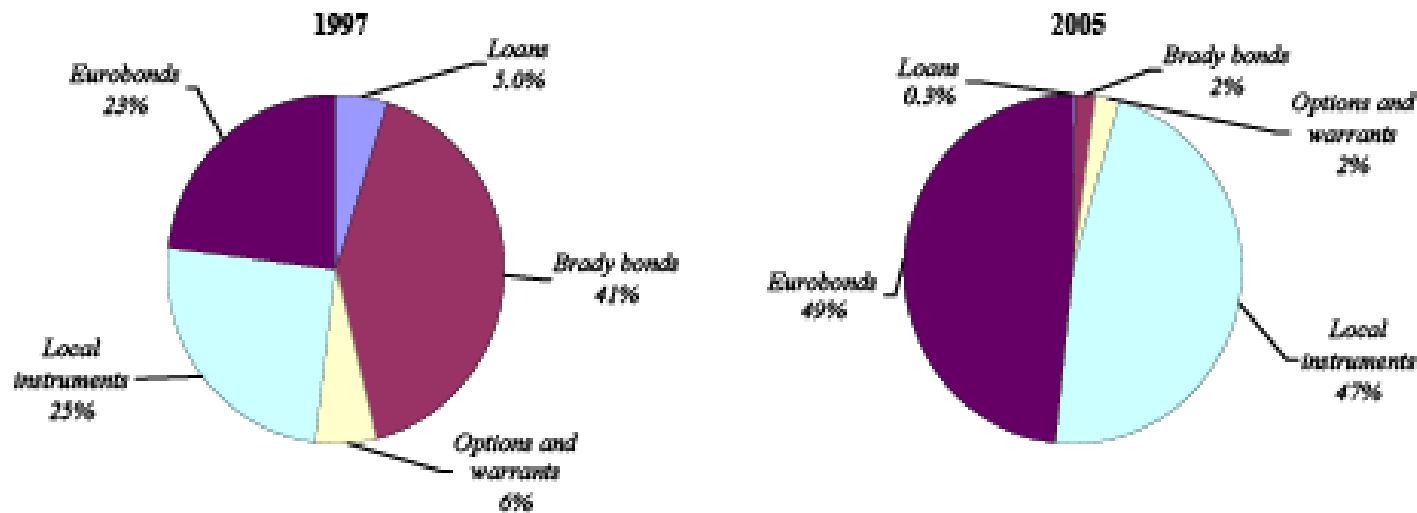
Demand

- Growing EM institutional investor base
- Cross-border investments from MM institutional investors
- Liberalization of investment regulations in the EM universe

Key challenge is to have the capacity to generate asset in EM countries

Scarcity of External Sovereign Bonds Pushing Investors To Search for Yields in Local Markets

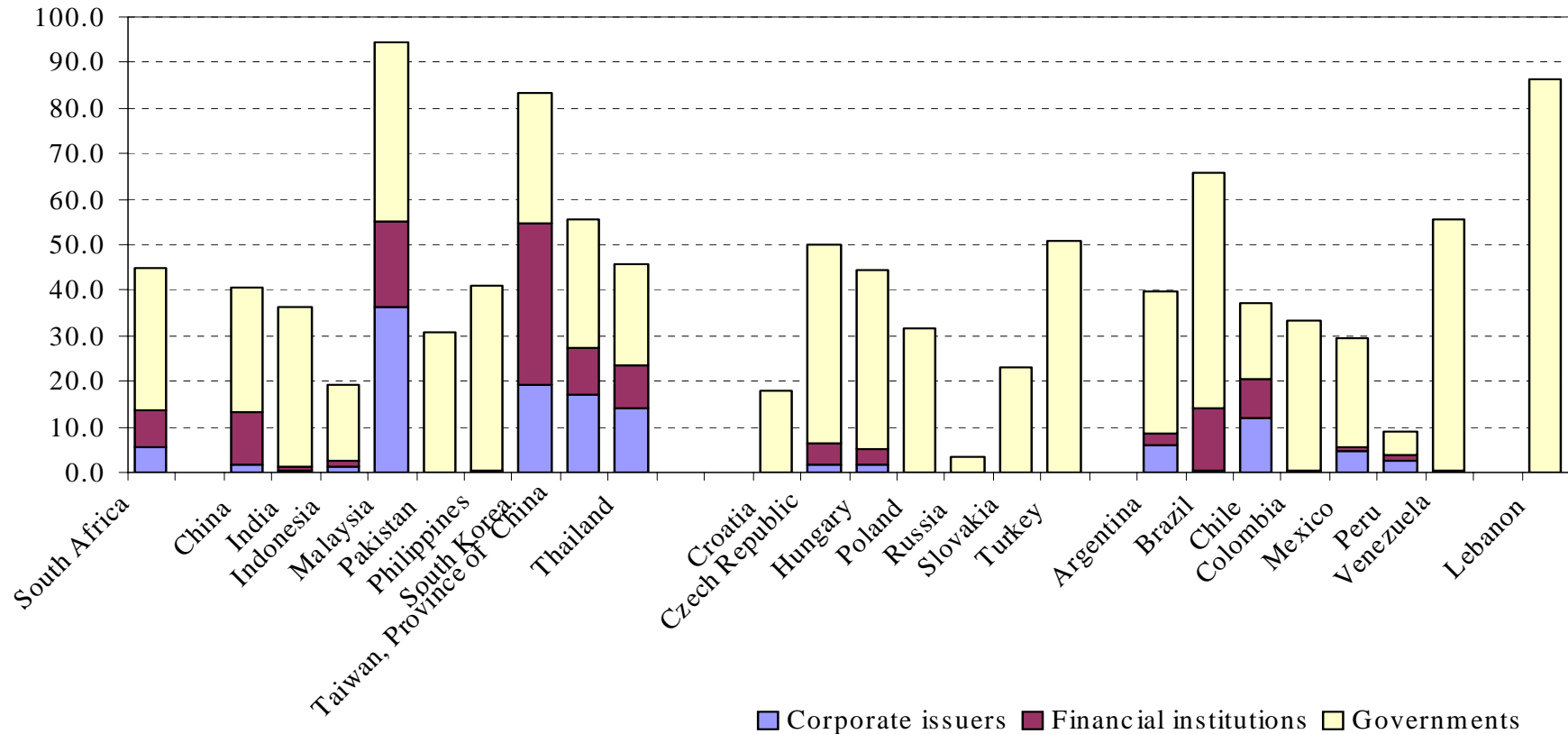
Emerging Market Debt Trading: Market Share by Instrument (%)



Source: EMTA.

Government Still Dominates The Local Bond Markets

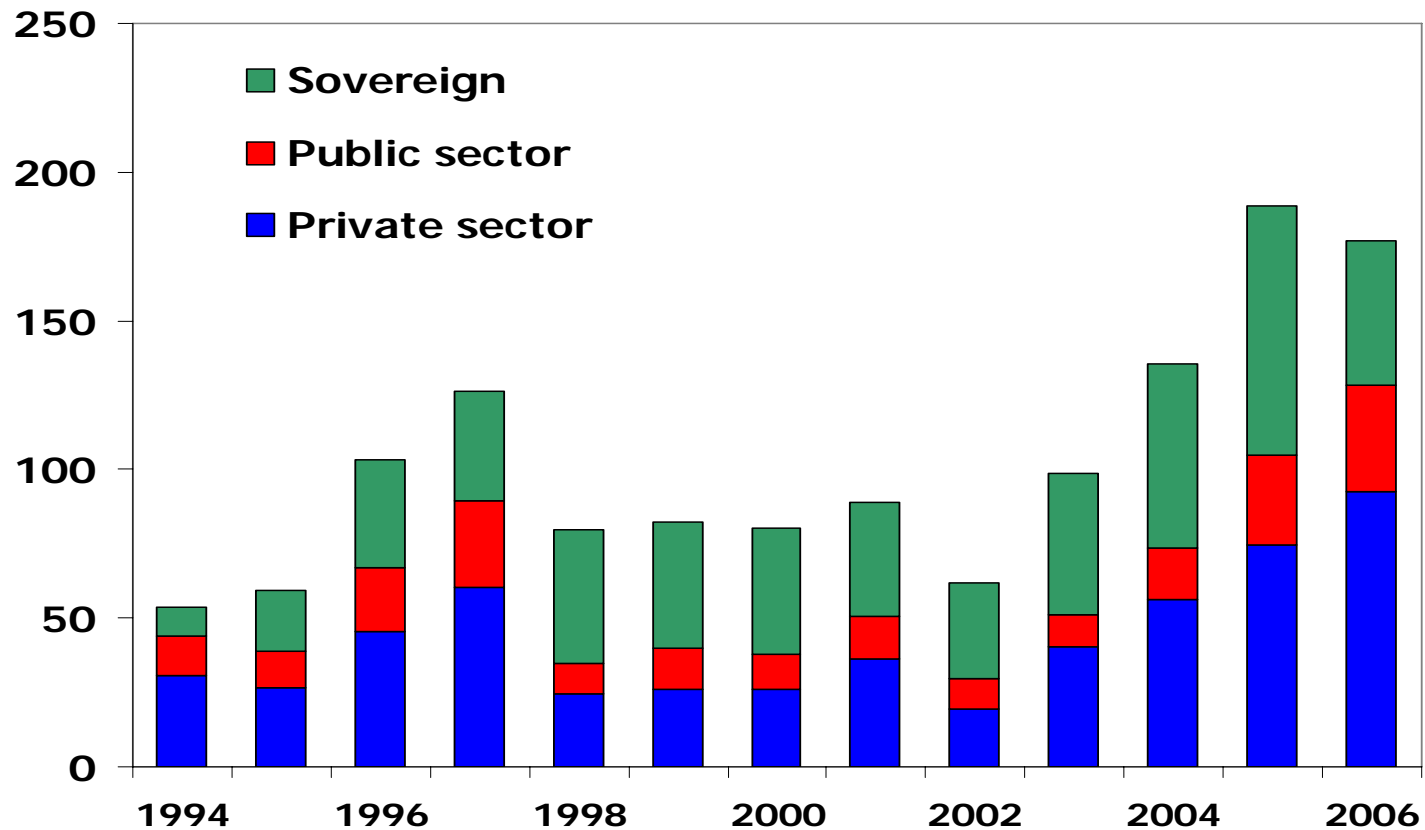
Composition of Emerging Market Outstanding Domestic Debt
(Percent of GDP, end 2005)



Source: BIS.

But Evidence of Crowding in of the Private Sector in The External Debt Markets

EM: Gross External Bond Issuance by Issuer Type
(In billions of U.S. dollars)

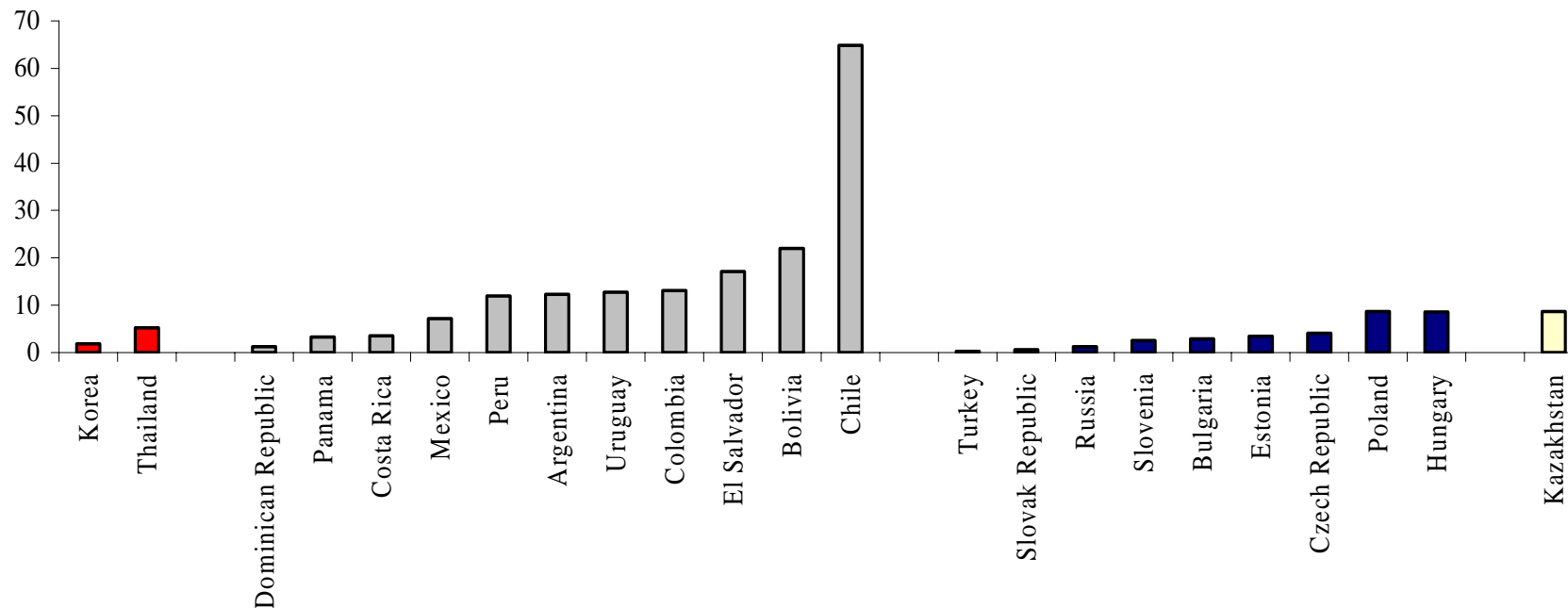


Source: Dealogic.

Domestic Institutional Investor Base Is Growing

- Higher institutional savings within EM countries
 - Pension fund reforms in EM Latin America and provident funds in Asia growing.

Pension Fund Assets in Selected Countries, 2005
(In percent of GDP)



Source: Investment Company Institute, European Fund and Asset Management Association, National Mutual Fund Association, OECD, Local insurance regulation institutions, IFS and WEO.

III. Capitalizing on the Positive Dynamics – Enhancing Information Flow in EM Countries



What can be done?

- Strengthening Local Bond Market Data
- Broadening Coverage to the Derivatives Markets
- Tracking the Investor Base
- Discerning Investor Asset Allocation Behavior
- Addressing Information Gaps In Cross-Border Capital Flows

Strengthening Local Bond Market Data

- Data foundations: size, maturity structure, depth and liquidity; information on primary issuance and secondary market trading.
- Generally, it is easier to obtain stock market data, as trading is largely concentrated at exchanges. Bond markets are more fragmented and data are less centralized.
- EM international bond market data is more comprehensive than domestic bond market data.
- But EM local bond market data coverage is limited.

Strengthening Local Bond Market Data

Market Size	BIS 
Maturity/Currency	Limited, Private Debt Managers
Issuance	Bloomberg and Dealogic
Second Market Activity	EMTA 
Market Indicators	Limited, GBI-EM
ABS	Limited, Dealogic



- Break downs by country of issuance, sector and remaining maturity for domestic securities (government, corporate, and financial institutions).
- Only aggregated information on amounts outstanding and net new issuances.
 - Information on individual securities and their characteristics not available. They can be made available to BOP compilers.
- The coverage of the corporate bond market is often weak.

EMTA



- Liquidity indicators like trading volume, turnover and bid-ask spreads are not comprehensively covered.
- The Emerging Markets Trade Association (EMTA) monitors and publishes data on trading volume. But these data are based on the survey of market participants mainly of foreign investors and dealers.
- EMTA database is weak on the Asian region, which partly stems from restrictions of foreign participation in the local bond markets. However, AsianBondsOnline is good source of such data.

Broadening Coverage to the Derivative Markets

- The derivative market is an integral part of capital market development.
- Data availability on EM derivative markets is weak.
 - Both OTC and exchange traded data are available on outstanding amounts of foreign exchange, interest rate, and credit derivatives.
 - No unified source of information.
- Key Sources: BIS, BBA, ISDA, WFE

Tracking the Investor Base

- Local debt market statistics are primarily covered from the borrower/issuer side.
- Need for a centralized and consistent database on domestic institutional investor assets (by investor type and by the allocation into asset classes).
- Weak Coverage of AUM of EM institutional investors.
- Data shortcomings in cross-border institutional flows.

Discerning Investor Asset Allocation Behavior

- Asset allocation is critical to understanding the investor decision-making process, its implications on asset prices and volatility of capital flows.
- More disaggregated data on both the investor base and the asset class they are investing in needed.
- EM institutional investors are restricted in their investment allocations. But with liberalization gathering momentum, there will be a need to track them.
- Asset allocation of foreign institutional investors will also need to be monitored more carefully.

Addressing Information Gaps in Cross-Border Capital Flows

- A general difficulty in obtaining accurate and timely information on the cross-border activity of the non-bank private sector, although BOP coverage of such data in many countries is available on a quarterly basis.
- The data problem is prevalent across MM and EM countries.
- In a world of increasing capital flows, the need to cover non-bank private sector activities has become more important
- The CPIS database developed by the IMF is helpful. However, it is survey-based and it still needs to expand coverage to provide desired comprehensiveness.

Ongoing Initiatives By IMF and other IFIs

- Reporting on external positions (IIP in SDDS).
- Enhancing CPIS data coverage.
- WB / IFC databases (EM database on financial sector indicators).
- Joint BIS/OECD/IMF/World Bank External Debt Hub (JEDH).
- Coordinated Direct Investment Survey at end-2009.

Summing up...

- It is in the interest of the EM countries to enhance the information flow (investor relations, disclosure, transparency).
- Ensuring data consistency across sources and countries will help the compilation of higher quality and comparable data.
- Integration of aggregate data across different sources into a centralized system (IFI initiatives).
- It would be beneficial to encourage non-bank private institutions to disclose data for market use (surveys etc).

IV. Technical Assistance: Role of IFIs

Technical Assistance: Need for a Collaborative Approach

- Increased collaboration between the IMF and World Bank
- Sharing of work programs and strategic planning of technical assistance
- Capital markets practitioners group
- Collaboration with other IFIs and bilateral TA providers

Areas of technical assistance I

- Sound and transparent regulatory, legal and accounting framework;
- Sound debt management practices: measures to ensure that the sovereign debt issuance and debt strategies are properly formulated and well executed;
- Efficient trading, custody, clearance and settlement infrastructure
- Development of investor base (enabling reforms, investment allocation guidelines);

Areas of technical assistance II

- Enhance regulatory framework to allow risk sharing and risk transfer through asset backed securities and derivatives markets;
- Enhance a culture of information disclosure: Investors need to have ready access to information to price assets, including corporate governance;
- Regional initiatives, reliance on international financial integration together with alternative solutions for access by enterprises.